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CITATIONS

760216—47——1

In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 261

SAMUEL EUGENE BRAMER, PETITIONER
v.
COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 3a–17a) is reported in 6 T. C. 1027. The *per curiam* opinion of the Circuit Court of Appeals (R. 30–31) is reported in 161 F. 2d 185.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 12, 1947. (R. 31.) A petition for rehearing was denied July 5, 1947. (R. 51.) The petition for a writ of certiorari was filed on August 12, 1947. The jurisdiction of

this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

A syndicate of which taxpayer was a member borrowed money from a bank to finance the purchase of Rustless stock. The Rustless stock which was purchased, together with securities owned by taxpayer's associates, were pledged to the bank to secure payment of the indebtedness. Part of the Rustless stock was sold by the bank at a loss in 1930. After a series of adjustments among the syndicate members and the bank, the remainder of the Rustless stock and the collateral posted by one of taxpayer's associates was sold by the bank in 1935. Did the taxpayer, who was on the cash basis, sustain deductible losses in 1930 and 1935 when the collateral was sold and his indebtedness to the bank was extinguished, as the Tax Court found, or might he postpone the taking of his loss until 1941 when he partially reimbursed the associate whose collateral was sold?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra*, pp. 18–20.

STATEMENT

The Tax Court found the following facts (R. 5a–12a):

In 1929, the taxpayer, then as now president of Copperweld Steel Company, was given an oral option by the Bank of Pittsburgh, N. A., to purchase 18,800 shares of stock of International Rustless Iron Corporation at a price of $3 per share. At the same time, L. B. Foster and William K. Frank were similarly given options for 10,500 and 12,500 shares, respectively. (R. 5a.)

Frank and Foster invited the taxpayer to participate in a syndicate for the purchase of 60,000 shares of Rustless stock. The taxpayer was without sufficient funds or collateral of his own to finance the purchase of the 18,800 shares which had been allotted to him and he agreed to pool his allotment with those of Foster and Frank after they had assured him that they would finance and handle the syndicate without any contribution of cash or securities by him. The taxpayer accepted the proposition. (R. 5a–6a.) A syndicate agreement dated September 24, 1929, was signed by the taxpayer, Foster, and Frank and reads in material part as follows (R. 6a–7a):

> At a special meeting called Monday, September 23, 1929, a Syndicate was formed to be known as the Bramer, Foster, Frank Syndicate, Lee B. Foster, Trustee, and W. T. Davidson, Secretary, to operate in the purchase and sale of International Rustless Iron Corporation stock.
>
> It was agreed that Messrs. Lee B. Foster and William K. Frank were to finance the Syndicate by negotiating a loan through

The Bank of Pittsburgh, N. A. secured by the following:

236 shares Weirton Steel Company owned by Wm. K. Frank.

250 shares Weirton Steel Company owned by Lee B. Foster.

The Bramer, Foster, Frank Syndicate is composed of Messrs. S. E. Bramer, Lee B. Foster, and Wm. K. Frank. Each member is to receive one-third of the net profits from the sale of the International Rustless stock, or one-third of all such stock remaining at the termination of the Syndicate after all debts have been paid and the above-mentioned Weirton Steel, or any other borrowed securities, returned to its respective owners. It is also agreed that any losses sustained by the Syndicate shall be borne equally.

It is further agreed that this Syndicate may be terminated, or any of the stock sold, upon the written direction of any two members.

Along the lines of the above agreement, the following purchases of International Rustless Iron Corporation stock have been made:

* * * * *

[60,000 shares total cost $236,752.50.]

All shares of the International Rustless Iron are to be paid for as delivered, and when delivery is completed the Syndicate will contain 60,000 shares at a cost of $236,752.50.

* * * * *

Foster and Frank negotiated a loan from the Bank of Pittsburgh, N. A., in the amount of $236,752.50. One note signed by taxpayer, Foster, and Frank was given to the bank to evidence that loan and the bank held all the 60,000 shares of Rustless stock purchased as collateral on the loan. None of the 60,000 shares of Rustless stock were ever registered in taxpayer's name and at least 41,800 of the shares were in street names. (R. 7a.)

From January 1, 1930, to July 14, 1930, 21,849 of the 60,000 shares of Rustless stock owned by the syndicate were sold for $45,209.55, and the proceeds were applied on the loan by the Bank of Pittsburgh, N. A. The taxpayer claimed on his 1930 return a loss of $13,667.41, being one-third of the excess of the average cost of 21,849 shares over the sales price thereof. (R. 7a.)

Between September 23, 1929, and July 14, 1930, Weirton Steel Company was reorganized into National Steel Corporation and William K. Frank deposited additional collateral on the syndicate note with the result that at July 14, 1930, the collateral deposited with the Bank of Pittsburgh, N. A., as security for the unpaid balance of the loan of $236,752.50 was as follows (R. 7a):

William K. Frank, 2,000 shares National Steel Corporation common;

Lee B. Foster, 1,161 shares National Steel Corporation common;

S. E. Bramer, nothing;

Bramer, Foster, Frank Syndicate, 38,151 shares International Rustless Iron Corporation stock.

On January 14, 1931, the taxpayer gave to the Bank of Pittsburgh, N. A., his individual note in the amount of $66,647.64 representing one-third of the unpaid balance of the loan mentioned above and pursuant to arrangements made with the bank by William K. Frank, the bank continued to hold as collateral on taxpayer's note the 2,000 shares of National Steel Corporation stock previously deposited by Frank as collateral on the joint note and 12,717 shares, one-third the balance of 38,151 shares of International Rustless Iron Corporation remaining in the hands of the bank after the sales in 1930 of 21,849 shares out of the original 60,000 shares. Foster and Frank made all arrangements with the bank for the split-up of the syndicate note into three parts without consulting taxpayer and the only thing taxpayer was asked to do was to sign a new note for $66,647.64 after Frank and Foster had settled with the bank for the other two-thirds of the balance of $199,942.93. (R. 7a–8a.)

The 12,717 shares of Rustless stock mentioned above were not registered in taxpayer's name but were continued to be held by the bank in street names after January 14, 1931, the same as before. (R. 8a.)

On January 14, 1931, the Bank of Pittsburgh, N. A., held two other notes of taxpayer on which the unpaid balances were $2,077.17 and $15,915.94, respectively. One of these notes had been given to the bank by the taxpayer on October 2, 1929, in the original amount of $17,400 secured by collateral consisting of 7,000 shares of Rustless stock. The second note had been given on June 17, 1930, for $15,915.94 collateralized as follows (R. 8a):

> 100 shares International Telephone & Telegraph Company.
>
> 300 shares Lone Star Gas Corporation.
>
> Also loan for $10,733.88 secured by 7,500 shares International Rustless Iron.

These two notes and the above-mentioned note for $66,647.64 provided that the property deposited as collateral security for payment of each note was also secured for "any other liability or liabilities of the undersigned to the holder hereof, now due or to become due, or that may be hereafter contracted." (R. 8a–9a.)

From the inception of the transactions relating to the Bramer, Foster, Frank Syndicate to August 5, 1935, (a) no payment of any kind was made by the taxpayer or by anyone on his behalf on account of the transactions described above relating to the syndicate operations other than the payments and credits mentioned below, and (b) all the shares of Rustless stock, namely, 38,151

shares, were held by the Bank of Pittsbugh, N. A., as collateral security until sold by the bank. (R. 9a.)

From October 3, 1932, to August 1, 1935, the Bank of Pittsburgh, N. A., received, and applied on the principal and interest of the taxpayer's three notes, dividends from 2,000 shares and proceeds of sales of 1,880 shares of stock of National Steel Corporation deposited by Frank in amounts aggregating \$101,051.11. In May, 1935, the bank sold the 38,151 shares of Rustless stock. The aggregate credits from May, 1935, to August, 1935, on the note of \$66,647.64, and accrued interest thereon, were out of proceeds of sales of National Steel stock (aggregating \$101,051.11) and out of the proceeds of sales of Rustless stock by the bank as follows (R. 9a):

Principal, \$66,647.64.
Interest, \$16,040.37.

Taxpayer's other two notes were paid out of the remaining proceeds of the collateral held by the bank. Taxpayer had nothing to do with the arrangements for the sales by the Bank of Pittsburgh, N. A., of any of the National Steel or Rustless shares. The sales were ordered by Frank and the bank did not consult the taxpayer. (R. 9a.)

Prior to August 1, 1935, W. K. Frank, whose collateral had largely been used in paying off the debt to the bank, transferred all of his claims against the taxpayer to W. K. Frank, Inc. The

taxpayer gave to such corporation his promissory note dated August 1, 1935, in the amount of $100,839.17 to cover the dividends from and proceeds of sales of Frank's collateral applied by the bank on petitioner's notes, less a small amount of cash refund to Frank by the bank in 1935 out of the proceeds of the sale of Rustless stock. Included in the principal of the note of $100,839.17 was $19,539.51 interest which had been paid by Frank on behalf of the taxpayer. (R. 10a.)

Taxpayer claimed as deductions on his 1935 return the interest of $19,539.51 which had been paid on his behalf by Frank in that year. He did not claim the deduction of any loss upon the sale of his *pro rata* share of the 38,151 shares of Rustless stock which had been owned by the syndicate. The Commissioner, however, on an audit of taxpayer's 1935 return determined that the taxpayer sustained a loss from the sale of his collateral and his interest in the syndicate stock of $86,203.33 and allowed the deduction of a capital loss limited to $2,000. (R. 10a.)

In 1941 the taxpayer paid $13,492.70 on the principal of his note of $100,839.17 given by him on August 1, 1935, and interest of $2,672.20. In the determination of the deficiency the Commissioner allowed the deduction of the interest paid in the amount of $2,672.20 but disallowed the deduction of $13,492.70 paid on the principal of the note. The deduction of the interest in the amount of $2,672.20 is not involved in this case. (R. 10a.)

For a number of years prior to 1941 the taxpayer owed debts of more than $600,000. These debts far exceeded his assets. His financial condition gradually improved and much of his income for 1941 and for a number of prior and subsequent years was used in liquidating his debts. (R. 12a.)

The taxpayer has always filed his income tax returns on a cash basis. (R. 12a.) The Tax Court held (R. 13a–15a) that the taxpayer was not entitled to deduct from his gross income of 1941 any part of the loss which was sustained by him upon sale of the collateral in 1930 and 1935. However, the Tax Court upheld deductibility in respect of a portion of the 1941 payment, since it found that such portion did not relate to the capital loss previously sustained, but constituted payment of accrued interest.

On appeal the Circuit Court of Appeals affirmed the decision of the Tax Court on the authority of this Court's decision in the case of *Dobson* v. *Commissioner,* 320 U. S. 489. (R. 30–31).

ARGUMENT

The Tax Court held, correctly, we submit, that the taxpayer was not entitled to take a loss deduction in 1941 when he made payment on the note, even though he reported his income on the cash basis. In so holding the Tax Court followed its own previous decision in *Larkin* v. *Commissioner,* 46 B. T. A. 213, which presents a com-

parable situation. In that case the Tax Court held that the taxpayer sustained a loss when the stock was sold because he owned it and had the real investment in it; therefore he was not entitled to take his deduction in a subsequent year when he paid a loan which he had obtained in order to buy the stock. In a companion case to the *Larkin* case, *Connelly* v. *Commissioner,* 46 B. T. A. 222, the Tax Court reached the opposite conclusion on the theory that the taxpayer had no real investment in the stock and sustained no loss until he actually paid his obligation. The Commissioner acquiesced in the *Connelly* decision. 1942-1 Cum. Bull. 4.

In deciding the *Larkin* and *Connelly* cases the Tax Court considered and distinguished the cases which the taxpayer in the instant case asserts (Pet. 6) are in conflict with the instant one. Those cases are: *Eckert* v. *Burnet,* 283 U. S. 140; *Helvering* v. *Price,* 309 U. S. 409; *Page* v. *Rhode Island Hospital Trust Co.,* 88 F. 2d 192 (C. C. A. 1); *Jenkins* v. *Bitgood,* 101 F. 2d 17 (C. C. A. 2d), certiorari denied, 307 U. S. 636. We submit that the distinctions are sound.

In the *Eckert* case, the taxpayer, being liable as endorser of the note of an insolvent maker, took up the note by substituting one of his own. He claimed the right to a bad debt deduction in the year the new note was given. The deduction was disallowed because the taxpayer was on the cash basis, and the Court said that a deduction

might be permissible in the taxable year in which the taxpayer paid the note. In the *Price* case the Court followed the *Eckert* case and held that the taxpayer, who was on the cash basis, was not entitled to deduct, as a loss sustained during the taxable year, the amount of a note given in settlement of his liability to a bank on a guaranty, even though the note was secured. This Court took the view (p. 413) that the collateral was not payment. The *Eckert* and *Price* cases are distinguishable from the instant one because they do not involve a situation where the taxpayer has a proprietary interest in property purchased with borrowed funds.

In the *Rhode Island Hospital Trust Co.* case the court took the view that the situation was sufficiently analogous to the *Eckert* case to justify the allowance of a deduction for losses in the year the notes were paid, even though the notes were given for a debt owing to brokers who had purchased securities for the taxpayer on margin. The court recognized the general rule that losses on security transactions should be identified by the sales of the securities, but held it was without application in the case of a grossly under-margined account where there is no certainty that the customer will ever be able to pay the broker in case of a loss. In such a case, there is room for the view that the customer has no real proprietary interest in the securities, and his loss is sustained,

not when they are sold, but when, if ever, he actually makes payment to the broker. And irrespective of whether the *Rhode Island* decision may be considered correct, it turns upon the peculiar facts of the case and is not necessarily inconsistent with the result reached by the Tax Court in the instant case, which was based upon the conclusion that the taxpayer was an owner of the stock in question.

In *Jenkins* v. *Bitgood,* the taxpayer was a director of a bank and the owner of some shares of its stock. In order to keep the bank open and thus protect his investment, he and other directors agreed to purchase some bonds owned by the bank for more than they were worth and he gave his note in payment. Later the stock became worthless, and taxpayer claimed the right to deduct not only his original investment but also the difference between the amount of the note and the value of the bonds when received, even though the note was not paid until a later year and he was on the cash basis. The court held that the situation was substantially similar to the one in the *Eckert* case, and denied the excess deduction on the theory that there was not a loan from a third party, and no real contribution of capital or additional investment until the note was paid. The situation differs from the instant one where the Tax Court concluded on all the facts that the taxpayer had in effect purchased the

stock with borrowed money and was the owner thereof so he should take his deduction in the year it was sold. Cf. *Jenkins* v. *Bitgood, supra,* p. 19.

The taxpayer urges (Pet. 8) that the Tax Court's reliance on its conclusion that he was an owner of the stock is misplaced, and is precluded by its further findings that he had not paid any cash at the time of the sales, and that he was insolvent. We submit that there is no basis for this criticism, and that the course of dealings of the syndicate, of which taxpayer was a member, together with the terms of the syndicate agreement itself, all of which are set out in the Tax Court's findings, *supra,* show clearly that the taxpayer was just as much an owner of the stock as the other two members of the syndicate, even though they undertook initially to supply the funds and obtained a loan through which the acquisition of the stock was financed. See also memorandum of July, 1930, modifying the syndicate agreement. (R. 27–29.) Indeed, it does not appear that the taxpayer was insolvent when the syndicate was formed in 1929, and it is evident that the subsequent sale of the Rustless stock for a nominal sum contributed in at least some measure to his financial difficulties. It seems plain, therefore, that the Tax Court had warrant for concluding that the taxpayer had a real proprietary interest in the stock and in effect borrowed money to pay for it so that any loss

would be sustained when the stock was sold and not when he paid his obligation.

The Circuit Court of Appeals apparently viewed the case in this light and therefore affirmed it on the authority of *Dobson* v. *Commissioner,* 320 U. S. 489. We submit that this action was appropriate. The instant case turns on its peculiar facts rather than upon the validity of a generalizing principle, and there is no clear-cut error of law in the Tax Court's decision; it should therefore be permitted to stand. *Dobson* v. *Commissioner, supra,* pp. 501–502; *John Kelley Co.* v. *Commissioner,* 326 U. S. 521, 529; *Choate* v. *Commissioner,* 324 U. S. 1, 3–4; *Commissioner* v. *Estate of Bedford,* 325 U. S. 283, 292; *Bazley* v. *Commissioner,* decided June 16, 1947, No. 287, October Term, 1946.

The taxpayer asserts (Pet. 8–9) that the application of the *Dobson* rule here is in conflict with the decisions in *Helvering* v. *Price, supra; Commissioner* v. *Heininger,* 320 U. S. 467; and *Security Mills Co.* v. *Commissioner,* 321 U. S. 281. We submit that there is no such conflict. True, this Court in the *Price* case, which incidentally was decided prior to the *Dobson* case, said (p. 412) that the legal effect of the transaction was reviewable by the Circuit Court of Appeals, but there a generalizing principle was involved. Moreover, it will be noted that this Court reversed the Circuit Court of Appeals and rein-

stated the decision of the Board of Tax Appeals in the *Price* case. In *Commissioner* v. *Heininger,* this Court said (p. 475) that the independent judgment of the Tax Court with respect to whether an expenditure is deductible as an ordinary and necessary expense of doing business, will normally be treated as final. In the *Security Mills Co.* case, the Court held (p. 286) that the Board of Tax Appeals misconstrued the extent of the power conferred by the Revenue Act to make exceptions to the general rule of accounting by annual periods. Hence the *Dobson* rule did not require an acceptance of the Board's erroneous decision. The *Price, Heininger* and *Security Mills Co.* cases do not hold or indicate that the *Dobson rule* is inapplicable in circumstances such as here presented. Here the decision turns in the last analysis upon whether the taxpayer should properly be treated as an owner of the stock in question, and the Tax Court's evaluation of the underlying facts being neither arbitrary nor unreasonable, its conclusion should be accorded finality. Cf. *Helvering* v. *Clifford,* 309 U. S. 331; *George* v. *Commissioner,* 143 F. 2d 837, 841–842 (C. C. A. 8), certiorari denied, 323 U. S. 778.

In the light of these considerations we submit that the determination of the Tax Court was properly affirmed by the Circuit Court of Appeals below and that there is no occasion for any further review of this case.

CONCLUSION

The decision of the court below is correct, and there is no conflict of decision. The petition for a writ of certiorari should, therefore, be denied.

Respectfully submitted.

PHILIP B. PERLMAN,
Solicitor General.

THERON L. CAUDLE,
Assistant Attorney General.

HELEN R. CARLOSS,
L. W. POST,
Special Assistants to the Attorney General.

SEPTEMBER 1947.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(26 U. S. C. 1940 ed., Sec. 23.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions * * * provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

(26 U. S. C. 1940 ed., Sec. 43.)

SEC. 3801. MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.

(a) *Definitions.*—For the purpose of this section—

(1) *Determination.*—The term "determination under the income tax laws" means—

* * * * *

(B) A decision by the Board of Tax Appeals or a judgment, decree, or other order by any court of competent jurisdiction, which has become final; or

* * * * *

(b) *Circumstances of Adjustment.* — When a determination under the income tax laws—

* * * * *

(2) Allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year. * * *

* * * * *

and, on the date the determination becomes final, correction of the effect of the error is prevented by the operation * * * of any provision of the internal-revenue laws * * * then the effect of the error shall be corrected by an adjustment made under this section * * *

* * * * *

(f) *No Adjustment for Years Prior to 1932.*—No adjustment shall be made under this section in respect of any taxable year begining prior to January 1, 1932.
(26 U. S. C. 1940 ed., Sec. 3801.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

Sec. 19.23 (e)-1. *Losses by individuals.*— * * *

In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses. Full consideration must be given to any salvage value and to

any insurance or other compensation received in determining the amount of losses actually sustained. See section 113 (b).

* * * * *

SEC. 19.23 (e)–4. *Shrinkage in value of stocks.*—A person possessing stock of a corporation cannot deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. If stock of a corporation becomes worthless, its cost or other basis as determined and adjusted under section 113 and sections 19.113 (b) (1)–1 to 19.113 (b) (3)–2, inclusive, is deductible by the owner for the taxable year in which the stock became worthless, provided a satisfactory showing is made of its worthlessness. Federal or State authorities incident to the regulation of banks and certain other corporations may require that stock be charged off as worthless or written down to a nominal value. If, in any such case, the basis of the requirement is the worthlessness of the stock, such charging off or writing down will, for income tax purposes, be considered prima facie evidence of worthlessness; but if the charging off or writing down is due to market fluctuations, or if no reasonable attempt has been made to determine worthlessness, no deduction for income tax purposes of the amount so charged off or written down can be allowed. For dealers in securities, see section 19.22 (c)–5. For limitations on deductions for losses from sales or exchanges of capital assets generally, including stocks and bonds, see section 117.

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